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Jun 3rd 2017 edition

Business and bureaucracy

Most of India's state-owned firms are ripe for sale or closure

Privatisation and politics sit poorly together

Jun 1st 2017

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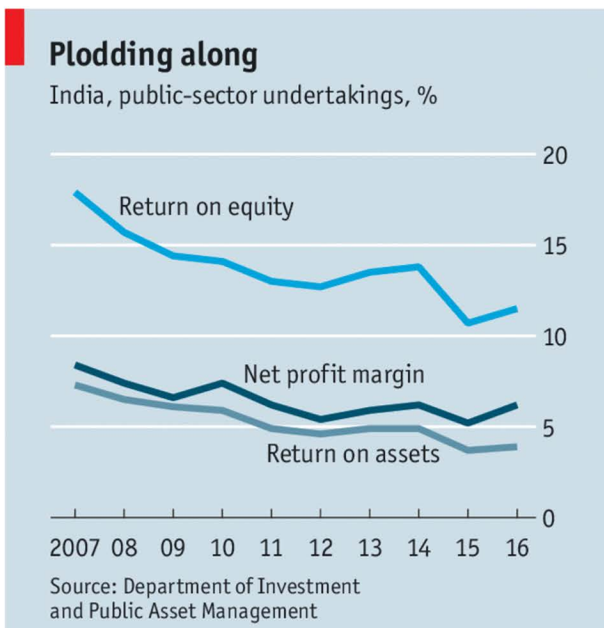
EARTH movers, fertiliser, artificial limbs, uranium, rickshaws, hotels, textiles, tea, mutual funds, petrol, broadband, pills, coal, fighter jets, sex toys and much more beside: the range of products and services purveyed by Indian state-owned firms would put even the most sprawling of conglomerates to shame. A legacy of India's socialist years from 1947 until the early 1990s when the country shifted towards a more market-based economy, few of the 244 "public-sector undertakings" (PSUs), as the government calls them, are paragons of productivity. Plans to slim down their collective girth, and so leave more room for the private sector in India's economy, are as tentative as they are overdue.

Roughly one in six of every rupee spent goes to a PSU. Only in China's avowedly communist economy does a greater share of spending go to state-owned firms. Often run by executives who have risen through the government bureaucracy,

they eke out profits mostly in industries where government fiat grants them lucrative monopolies, such as coal and oil. Even in a buoyant economy, one in three made losses in the year ending in March 2016. One in five has racked up three years of straight losses including BSNL, a telecoms operator which offers 3G services in a market where 4G ones are the norm. Another example is Air India, a financial black hole that flies habitually-delayed aeroplanes.

That 1.2m Indians toil in companies that form part of the relatively unproductive PSU sector, a traditional mainstay of formal employment, is largely seen as a benefit, not a problem. But if labour is abundant in India, capital is not, and state-owned firms guzzle it. The assets they sit on are worth an estimated $500bn. Excluding four firms that have lucrative state-mandated monopolies, their return on capital employed is a meagre 8% and falling. Most gauges of financial returns have been on a long decline (see chart). That spells rapid value destruction in a country where a company's weighted cost of capital is usually in the double digits.



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Not all are financial disasters. Some 80% of the total profit made by state-owned firms, or 1.2trn rupees ($18bn), comes from coal, petroleum products, power generation and oil PSUs. They receive regulatory protection that helps them relative to private-sector rivals. That does not mean they are efficient: Coal India, the biggest PSU by most measures, reportedly has an output per man-shift

that is just one eighth that of Peabody Energy, an American rival. India has both funded a PSU domestic jet-fighter programme at vast expense, and bought similar jets from a French supplier, Dassault Aviation, when the homemade plane failed to meet the air force's needs.

Worse problems arise when flat-footed PSUs face the market. The economic liberalisation of the early 1990s introduced competition in many consumer-facing industries. This shunted PSUs off the commanding heights of their respective parts of the economy. Air India (the only airline whose cabin livery makes a brand-new Boeing Dreamliner appear mired in the 1970s) has lost money continuously since 2007, barely managing an operating profit even after a crash in the price of aviation fuel propelled its private-sector rivals, such as Jet Airways, to vast riches.Mostly, PSUs have drifted from monopolist to bit-player. Air India is a fading force. Few Indians willingly use PSU telecoms providers. Public ports have gone from handling nearly three-quarters of stuff being shipped in and out of India less than a decade ago to just over half now. HLL Lifecare went from being a monopolist condom-maker to an also-ran, hence its more recent foray into vibrating gizmos.

State-owned banks are in a league of their own in terms of dominating their sector: they form a network of 21 listed but government-controlled entities that account for 70% of India's banking system by assets. Many of their loans are unlikely to be repaid, a state of affairs that private lenders usually manage to avoid. The latter are growing at a rapid clip: they are responsible for nearly all the growth in the financial system. In the early part of 2016, the market capitalisation of all 21 listed public-sector banks was on a par with that of a single private rival, HDFC Bank, set up back in 1995.

The result is what Ruchir Sharma of Morgan Stanley, a bank, calls "privatisation by malign neglect": the PSUs stay in state hands, but their market share (and their value) seeps steadily to nimble newcomers. Soft loans, subsidies and bail-outs keep them afloat, protecting unproductive jobs at vast expense.

Such neglect has resulted in pockets of acute financial distress. Nearly two dozen PSUs have loans greater than their total assets; 84 generate too little operating profit to cover the interest on their borrowings. And PSUs owned by India's 29 state governments, of which there are thought to be over 1,000, are if anything in worse shape. A recent bail-out of local power distribution companies, which

in worse shape. A recent bail out of local power distribution companies, which traditionally have overlooked non-payment of bills by customers whose votes

politicians craved, has resulted in a vast and costly debt restructuring which has weighed heavily on the public finances.

Poor performance by PSUs is hardly surprising given the way in which they are managed. A report from the authorities in 2011 described how "over-governance promotes conservative, cautious and risk-averse organisational culture, with procedures being paramount and outcomes secondary." Bosses with no obvious qualification—the managing director of Air India, for example, is a rail and tourism civil servant—are overseen by pliant boards. Better not to make decisions than to make one which could attract the attention of the auditors who oversee public spending.

Pay scales borrowed from the bureaucracy mean chief executives get paid around $50,000, pushing the brightest sparks to the private sector. Replacing them is hard: according to a recent report in *Asian Age*, a newspaper, as many as 42 PSUs are lacking bosses after a change in the method to appoint managers in June 2016 stalled any new hires.

Even the 47 non-bank, listed PSUs, where the government owns a majority and calls the shots, are run for motives that include profit but much else besides. Just under half of all jobs are earmarked for selected, disadvantaged castes; a quarter of all unskilled workers must be ex-servicemen or dependents of those killed in action. Little thought is given as to whether such aims, noble as they might be, are best met through maintaining largely unprofitable corporate structures.

PSUs are made to foot the bill for government programmes that are uneconomical. Coal India and NTPC, a power utility, have been asked to revive two defunct fertiliser plants, in Jharkhand and Uttar Pradesh, for example, largely on the grounds that they have spare cash. The government also wants state-owned enterprises to take over running companies that have defaulted on loans made by all those state-owned banks (the default was often for good reason).

Many had expected the era of PSUs to be drawing to a close by now. A few were

privatised in the early 2000s by a right-wing government which—not coincidentally, some think—was booted out of office soon afterwards. Narendra Modi, while running for prime minister in 2014 declared: "I believe that government has no business to be in business."

Sell-offs have long been mooted but have yet to materialise. Vaunted "disinvestment" of PSUs has so far consisted of listing them, or selling stakes in those already listed, while making sure the government keeps majority ownership. Neither achieves much. Around 462bn rupees was raised in this way in 2016-17, which was below the target that had been set but a significant increase from previous years. Many stake sales happen in the last few weeks of the financial year when the government is desperate to balance its books. PSU assets are sold to other PSUs, or to state-owned pension funds, doing little to shrink the overall size of the state.

Ominously, two years into Mr Modi's mandate, in April 2016 the so-called Department of Disinvestment was rechristened Department of Investment and Public Asset Management. Some suggest Mr Modi is lukewarm about flogging PSUs. As chief minister of Gujarat for over a decade before his rise to national office, he turned around a slew of state-owned firms there, and is said to believe the same can be done at national level. Job creation is perceived as one of the weakest spots in an otherwise solid economic record: privatising PSUs now, only to see them fire lots of workers in the run-up to elections in May 2019, is a non-starter.

Some progress has been made. Reformers hope that more minority stakes in companies being listed may force improvements in corporate governance. About a dozen "sick" PSUs, a euphemism the authorities use for often deeply dysfunctional firms, are in the process of being closed down. Many of them have had years or decades of no production (but plenty of workers still clocking in and out of factories, if only to pick up paychecks). Hindustan Photo Films, based in Tamil Nadu, whose black-and-white production equipment has been obsolete for decades, and Hindustan Cables, based in West Bengal, which stopped making said cables in 2003, are no more. Air India is now openly discussed as a sell-off candidate.

But moving from discussion to divestment has proved hard. "Privatisation is the

But moving from discussion to divestment has proved hard. "Privatisation is the art of the possible," says Arun Jaitley, the finance minister. Ministries protect the PSUs on their patch, which give their bureaucrats considerable power of patronage, for example when dishing out contracts. Labour unions that are affiliated with political parties are intent on stymying reforms. Extracting bureaucrats from India's boardrooms is likely to prove a slow process.

This article appeared in the Business section of the print edition under the headline "The everything makers"

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